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ABSTRACT

The economics of book publishing are described in this study completed for the National Commission on Libraries and Information Science. Segments of the book industry are compared by annual sales and titles published, as is profitability by categories of publishing. Operating statements of major categories are examined and capital requirements and returns on investment are compared by categories. Editorial and royalty costs; manufacturing costs and the economics of scale in hardbound and paperback publishing; sales and promotion costs; costs of mass sales and on-demand fulfillment; and general and administrative costs are discussed. Categories of income from secondary rights and risk factors in pricing in relation to unit costs and estimated sales are described. Special economic problems engendered by returns of unsold books and advances to authors are evaluated, along with advantages and costs of overseas distributors and pitfalls facing book publishers in periods of rapid technological change. (Author/PF)

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AN ECONOMIC PROFILE OF THE U.S. BOOK INDUSTRY

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Economics of Book Publishing: A Foundation for the National Program. This study (1) compares segments of the book industry by annual sales and titles published; (2) compares profitability by categories of publishing; (3) examines operating statements of major categories; (4) compares capital requirements and returns on investment by categories; (5) describes editorial and royalty costs; (6) compares manufacturing costs and the economics of scale in hardbound and paperback publishing; (7) describes sales and promotion costs; (8) compares costs of mass sales and on-demand fulfillment; (9) describes general and administrative costs; (10) compares categories of income from secondary rights; (11) describes risk factor in pricing in relation to unit costs and estimated sales; (12) evaluates special economic problems engendered by returns of unsold books and advances to authors; (13) describes advantages and costs of overseas distributors; and (14) describes pitfalls facing book publishers in periods of rapid technological change.

NOVEMBER, 1974

The views expressed are those of the author and do not necessarily reflect the position or policy of the NCLIS. Though related to the Commission's National Program, papers in this series are not an integral part of the National Program Document.

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Some Economic Characteristics of the Industry. Since the end of World War II, the book industry of the United States has enjoyed steady and healthy growth. In the past decade alone, its dollar sales volume almost doubled, increasing from $1.7 billion in 1963 to $3.2 billion in 1973. The annualized growth rate for the period was 6.3%. But these high-flying figures do not give a true picture, for the rate of real growth was far lower. By applying a proper dollar-price inflation factor, one discovers that the real growth in the decade was from $1.7 billion to $2.2 billion, and that the annualized rate was only 2.1%. (The factor here applied is 3.7525% per year, which is the official U.S. consumer price inflation rate for the decade.) [1] To put it another way, of the $1.5 billion sales increase, only $.5 billion was real growth in productivity, while $1 billion resulted from price inflation. How deflating is the inflation factor!

Despite its healthy rate of sustained growth, book publishing has remained a relatively small industry in the scale of American big-business enterprise. For many years, it has ranked in sales volume far down the scale; in fact, down a little lower than pet foods and only slightly above processed peanut products. By comparison, the billings of the General Motors Corporation in any good month alone in this period would equal the annual sales volume of the total book industry.

Table 1 provides a breakdown of industry sales for 1973 by the twelve major categories of publishing as reported to the Association of American Publishers. Also shown is the rate of sales increase for each category for the preceding decade 1963-1972.

Table 1. BOOK INDUSTRY SALES BY CATEGORIES - 1973
(Millions of Dollars)

Category	$ Volume 1973	% of Total	% Increase 1963-1972*
Adult Trade	351	11.0	180
Juvenile	109	3.4	32
Peligious	125	3.9	60
Professional	405	12.7	129
Book Clubs	262	8.2	150
Mail Order Books	221	6.9	N.A.
Mass-Market Paperbacks	286	8.9	190
University Presses	43	1.3	128
School Texts	548	17.2	63
College Texts	392	12.3	134
Standardized Tests	29	0.9	108
Subscription Reference	262	8.2	(27)
All Others	164	5.1	73

*This comparison is given because the 1973 industry sales figures are not exactly comparable with those of the preceding ten years.

There are no reliable industry statistics on the end use of books purchased annually in the United States, but industry analysts estimate roughly that the division in dollar volume is about equal between educational and non-educational uses.

Besides being relatively small, the book industry is highly fractionated. Bowker's Literary Market Place currently lists 999 firm names, and there must be at least that many more of specialized and local publishers that are not listed in that directory. This unusual fractionation of an industry of modest size has three important economic consequences: (1) keen competition for authors and for the buyer's dollar, (2) high levels of production and distribution costs, and (3) the existence of a large number of small houses that, while growing, must operate at a disadvantageous economy of scale. The phenomenon of fractionation has continued year after year, despite the large number of mergers that have characterized the industry over the past two decades. This is because it still

is possible to make a start on a shoestring in many areas of book publishing. Indeed, it seems that for every merger, there are at least two new firms started each year. In any case, the number of houses has increased steadily and rapidly. Against the 999 firms that are listed in the 1974 edition of Literary Market Place, only 559 were listed in the 1954 edition.

According to annual statistics compiled by Publishers Weekly, the U.S. book industry produced 31,951 new and revised titles in 1973. The totals for 1963 and 1953 were 25,874 and 12,052 respectively.[2] This record indicates a rate of increase that almost matched the rate of real growth in dollar sales volume. It discloses another kind of continuous fractionation that has a dampening influence on the economy of the industry -- the continuous fractionation of the total market by the large number of new products offered each year.

While the increase in the number of titles published annually seems to indicate a thriving industry, it also points up a negative economic characteristic. This is the production every year of thousands of new products that do not and cannot have the benefit of market testing. Publishers simply cannot afford to make any sort of market test for more than one or two in a hundred of their new books. Their markets are too difficult to identify, too ephemeral and elusive, and the profit potentials are too small to justify the expense. This condition produces a high risk factor, which has costly consequences for the industry, especially for the noneducational sector.

Still another economic characteristic that has costly consequences is the industry's complex and irrational marketing system. Most publishers market their wares indirectly through jobbers, specialty sales agencies, exporters, and retail booksellers; and directly to libraries, institutions, and individual customers. Paradoxically, almost all firms have many too many customers. The larger ones sell to

as many as 15,000 to 20,000 "trade" (dealer) accounts, and to as many individual (direct-by-mail) customers as they can find -- and some manage to find as many as 100,000 to 200,000 of the latter in a good year. Serving such a myriad of customers is costly; it also causes confusion and unhealthful competition in the marketplace. What the industry sorely needs is an effective system for wholesale distribution of its product.

Profitability. The profitability of the total industry can only be estimated from what is known of the profitability of its various segments and of the contribution of each segment to the sales composite. By this method, an estimate of 5.6% on sales after taxes would be approximately accurate for 1973. This rate is about average for the communications industry. It is low by comparison with many major U.S. industries. For other segments of the communications industry, the 1973 rates were: newspapers, 10.3%; business magazines, 7.1%; broadcasting, 6.5%; consumer magazines, 3%. For certain other major industries, they were: utilities, 12.3%; computers and office equipment, 10%; petroleum, 8.2%; chemicals, 7.5%; paper, 6.2%.

The range of profitability among the several major segments of the industry is quite wide. Currently professional book publishing (scientific, technical, business, law, and medicine) is at the top with an after-tax rate on sales of 8-9%, while trade-book publishing and mass-market paperback publishing are at the bottom with rates of 4-5%. The school textbook segment and the book clubs/mail-order segment each ranks near the average level with rates of 5-6%. College textbook publishing does a little better with a rate of 6-7%.

As for rates of return on invested capital, dependable industry information is very scarce. This is because many firms are wary of revealing their balance sheet figures -- and indeed many that are operating units of conglomerates do not have balance sheets of their own. However, an analyst who knows about financial relationships in the major segments of the industry (such as the relationships of inven-

tories and accounts receivable to net sales and operating profits) can construct models which indicate that the current rate of return on investment for the average profitable firm is within the range of 12-16%.

Capital Requirements. One close student of the economic development of the book industry has estimated that in order to grow as it did in the 1960s, the industry required an input of new capital of $2 billion.[3] Considering its low rates of earnings, the industry certainly was not capable of plowing back anything like that much of its cash profits in those years. (Indeed, many firms were growing so fast that they were unable to throw off any cash profits at all.) How, then, was this heavy financing requirement met? By classical methods, in most cases: Companies either went public, or they merged, or they were acquired by conglomerate corporations (holding companies) that could readily raise the required investment capital.

No matter how the new capital resource was come by, it usually added to the financial burden of the operating company. Working capital had to be borrowed at increasingly high rates of interest, and cash profits had to be provided for dividends by the parent (holding) company. Either, and sometimes both, of these requirements often depressed a company's sustainable growth rate. Naturally, with the soaring of interest rates, the burden of borrowed capital has become increasingly heavy in recent years. All this partially explains why the common stocks of so many publishers are currently selling at such low prices.

Profit and Loss Statements. This discussion must be limited by space requirements to a consideration of major income and expense items, with attention to these items that have significant variation among the several principal segments of the industry. Also, it is limited to operating figures only, not taking into account such non-operating items as interest earned on invested capital, interest paid on loans, etc. Its purpose is to provide a quick run-down of the items that appear in the operating

statements of most firms, and thus to give the reader a summary view of the publishers' income, receipts, and margins for profit.

The complete Profit and Loss (P & L) statement starts with Gross Sales, which states the value of all goods billed and shipped in the period covered. (This is the net amount after the allowance of discounts, which can vary from 10% for highly specialized technical and reference books to 50% for mass-market paperbacks.) From this is taken the amount of Returns of unsold books--usually a figure that makes the publisher groan audibly. The remainder is the amount of Net Sales, from which is deducted the Cost of Goods Sold, including production costs and royalty costs. The result after this deduction usually is labeled Gross Margin on Sales. All the customary items of operating expense, which will be described below in some detail, are deducted from the amount of this margin to produce Net Income from Operations. After an adjustment for nonoperating income and expense, and after the deduction of the cost of income taxes (federal, state, and local), the statement is brought down to the "bottom line," which usually is labeled Net Income.

By far the largest item in any publisher's profit and loss statement is production cost. (For accounting purposes, this item usually is divided into (1) so-called "plan costs, which include the costs of copyediting, typesetting, proofreading, page makeup, engravings, and plate making, all of which go into the making of the theoretical first copy, and (2) manufacturing costs, principally those of paper, presswork, and binding, which are involved only in the replication process.) The ratio of production costs to net sales typically ranges from a high of 40-44% for trade books to a low of 26-30% for professional books. For college texts, the range is 28-32%, and for school texts, 33-37%.

Royalty costs also have a fairly wide range--between 14-18% of net sales for college texts; 12-15% for trade books; 10-14% for professional books; 5-8% for school

texts. The lower rate for professional books is due largely to the fact that a sizable component of this category of sales is produced by handbooks and other compilations, on which only low editors' royalties are paid. (The publisher nearly always pays directly for authors' contributions.) The low rate for school texts recognizes the fact that the publisher's editor usually does a large share of the author's work in the writing of a basal textbook.

Marketing costs are relatively high in all segments of the industry. The principal two reasons for this are (1) the large numbers of new products that are launched each year and (2) the keen competition for the purchaser's dollar, especially in textbook markets. Total marketing costs range from a high of 20-24% for school book publishing to a low of 12-16% for college publishing. For trade and professional books, the rates are about 14-18% and 15-19%, respectively. As a rule, advertising and promotion expense runs high in trade and professional book publishing and low in educational publishing. Conversely, field sales expense runs high in educational publishing and low in trade and professional book publishing.

Editorial expense is not a major item in most P & L accounts. For each sector of publishing, the range is about the same, from 4% to 7% of net sales. This item represents only the cost of acquiring publishable manuscripts. The cost of copy-editing a finished manuscript usually is charged directly to the "plant" cost of the book, thus becoming a part of its production cost.

Order fulfillment costs are high for trade publishers, 8-12%, and not so high for the other segments, around 5-8%. The high cost of handling returns of unsold books sorely penalizes both trade and college publishers, and the latter more so because normally trade books are both ordered and returned in smaller quantities.

General and administrative costs are much the same for all segments of the industry, running quite consistently at about 10-12% of net sales.

There remains one other P & L item which usually appears down near the "bottom line" and has little importance except in trade book publishing. It usually is labeled Other Publishing Income, and it represents income from so-called secondary publishing rights -- income from the sale of rights for paperback and book club reprints, and for serialization, translation, dramatization, etc. Such income customarily is shared with authors, who usually receive no less than 50% of the gross amount. This income is highly important to trade publishers because, without it, most of them would show an operating loss every year. The only other substantial beneficiary of this kind of income is the scientific and technical book publisher. His income from the sale of translation rights can add as much as three or four percentage points to his operating profit.

The P & L accounts of book clubs and mass-market paperback publishers are not here dealt with because, being largely reprinters of published books and not having any of the major costs of first publication, they are, by function, really marketing and distributing enterprises rather than complete publishers.

Editorial Expense. As noted above, this item of expense usually covers only the costs of procuring publishable manuscripts: the salaries and expense of staff editors and readers; the fees and retainers paid to outside reviewers and consultants; and, occasionally, the cost of a rewrite of a manuscript by an outside professional. Naturally, a substantial portion of this editorial procurement expense is non-productive in that it is spent on exploring and reviewing proposals and manuscripts that are never accepted for publication.

The comparative cost of editorial expense depends largely on whether manuscripts are reviewed and selected on the basis of personal, subjective judgments of house editors, or on the basis of impersonal, objective evaluation and recommendation by outside advisers. Thus it happens that the editorial expense of the publisher of professional books is higher than that of the trade book publisher. And it follows, naturally, that the ratio of outside to in-house expense also is much higher for the former. The editorial expense of the college publisher is comparatively high because he, too, has to evaluate manuscripts on the basis of objective and professional outside advice. The editorial expense of the school book publisher is comparatively low because he concentrates on a small number of manuscripts, and he usually charges the expense of perfecting each as a part of the "plant" cost of the new book.

Publishers often are asked why they do not spend more time and effort on the editorial perfection of their books. The answer involves several factors. First, as it is with market research, the potential sale and profitability of the average individual title may not justify a high amount of editorial cost. Second, the time element usually is important -- a book might have to be published for a seasonal market, and the author nearly always is impatient to see his book in print. Third, most authors resist extensive editorial revision of their manuscripts. The publisher has to rate all these factors in deciding the limit of editorial expense for

each book, being aware in every case that the added value of editorial perfection is his most important obligation to both the author and the potential reader.

Royalty Costs. A traditional principle of book publishing is that the royalty payment should be such that the potential profit on a book will be shared equally between the author and the publisher. And, contrary to popular belief, it does work out that way generally. For it is a fact that almost every reputable publishing house annually pays its authors as much or more in royalties than it earns in operating profit. Indeed, royalty payments often are much higher than publishing profits, and especially so in trade book publishing where an author's earnings, including income from subsidiary rights, can be double or triple the amount of the publisher's profit.

Another traditional principle is that the author's royalty is specified on a sliding scale which effects a sharing of the publishing risk up to a point where the publisher recovers its out-of-pocket investment and thereafter makes a profit. Thus, for several decades a "standard" publishing contract has specified royalty payments on a sliding scale of 10% of the list price on the first 2,500 copies sold, 12 1/2% of the second 2,500 copies, and 15% thereafter. This arrangement assumes that the publisher's breakeven point is at or near the sales level of 5,000 copies. For many professional books which are published for limited markets and at higher prices the breakeven point is assumed to be at or near the 3,000 sales mark, and the sliding scale is based on increments of 1,500 copies. Conversely, for trade books that usually have low profit margins and high risk factors, the breakeven point is customarily taken to be 10,000 copies, and the sliding scale is based on increments of 5,000 copies.

In spite of the traditional principles and of the standard norms of the industry, the question of royalty rates usually is settled on an individual basis of mutual trust and confidence between the publisher and the author or the author's

agent. It goes without saying that competition for the successful author, or for the untried author whose professional competence is widely recognized, has an elevating effect on royalty rates in every area of publishing.

Production Costs. Since only a few book publishers have their own printing and binding facilities, most books are manufactured by contracted suppliers. Usually, the smaller houses contract for their production on a book-by-book basis; the larger ones have long-term contracts with their principal suppliers -- contracts that often specify price rates which are protected by escalation clauses. However, some publishers do buy the paper for all their printing requirements and supply it to their printers as needed.

Because so many hand skills are involved, book production is a labor-intensive process from beginning to end. Of the total costs of producing the average case-bound book, the components are about 75% for labor and 25% for materials. There are, of course, variations in this pattern. For a technical monograph requiring a combination of Monotype and hand composition and a printing of only 2,000 or 3,000 copies, the labor component can run as high as 90%. For a novel requiring Linotype or cold-type composition and a printing of 50,000 or 75,000 copies, it can run as low as 20%.

In accounting for production costs, the customary division is between "plant" cost and "manufacturing" cost. As noted earlier, the former is the cost that goes for the making of the theoretical first copy. It is the same amount no matter whether 1,000 or 100,000 copies are to be printed. In arriving at a "unit" (or per copy) cost, the amount of this fixed cost is spread over the quantity of the printing. Thus it is highly important in short-run printings and far less important in long-run printings.

Of the three components of "manufacturing" cost -- paper, presswork, and binding -- only the cost of presswork varies importantly with the quantity of the printing. The per copy cost of paper and binding is almost the same, no matter how large the print

order is beyond the first few thousand copies.

By putting all the production cost factors together in a tabulation that shows the effect of variables in a wide range of printing quantities, one can perceive how the economy of scale affects the per copy cost. Table 2 is based on estimated current costs of producing a typical 384 page book in 6" x 9" format with Smyth sewn sheets and hard-cover binding. (Estimated costs at September 1, 1974, which had increased by about 12% in eight months.) The table shows the high unit costs of small printings; also, it discloses how quickly the law of diminishing returns sets in with respect to the reduction of such costs by increased size of printings. This phenomenon is the main reason why first printings are kept down in size to a level that is surprising to most people who are not familiar with the economics of book production. For example, at McGraw-Hill -- a large firm with a widely varying list of over 400 new hardbound titles each year -- the average first printing is currently about 9,000 copies, while the median size is about 5,000 copies.

Another variance in production cost that surprises many people is the slight difference between the total costs of producing a book in hard covers or paper covers. The difference is slight because the plant, printing, and paper costs are the same no matter what kind of cover is put on the book. Also, a large part of the cost of the binding process -- that of folding, gathering, and trimming the sheets -- is the same. Thus it is only the costs of the binding materials, of the sewing of sheets, and of the casing-in process that can be higher or lower. Table 3 shows the narrow range of the differences in the total cost of producing the same book (the model used in Table 2) in five different kinds of binding.

The comparison between the costs of paperbound and clothbound books is not intended to imply a similarly narrow gap between the cost of a clothbound original edition and that of a typical mass-market paperback reprint edition. Rather, it

TABLE 2. ECONOMY OF SCALE IN BOOK PRODUCTION

COPIES PRINTED (THOUSANDS)	1.0	2.5	5	10	25*	50	100
FIXED COSTS							
PLANT $10,000	$10.00	$4.00	$2.00	$1.00	$ 0.40	$.20	$0.10
VARIABLE COSTS							
PRINTING	.41	.20	.13	.09	.09	.09	.08
PAPER	.27	.25	.25	.24	.24	.24	.24
BINDING (Hard Cover Sewn)	.62	.50	.46	.44	.42	.37	.35
SUBTOTAL	$ 1.30	$ .95	$ .84	$ .77	$ .75	$.70	$ .67
TOTAL PER COPY COST	$11.30	$4.95	$2.84	$1.77	$1.15	$.90	$ .77

TABLE 3. ECONOMY OF PAPER COVER VS. HARD COVER BINDING AND SMYTH SEWN VS. ADHESIVE BOUND
(Same Book - Various Bindings)

COPIES BOUND (THOUSANDS)	1.0	2.5	5	10	25*	50	100
HARD BINDING - Smyth Sewn and Plastic Cover	$11.60	$4.95	$2.84	$1.77	$1.15	$0.90	$0.77
HARD BINDING - Smyth Sewn and Cloth Cover	11.38	5.03	2.92	1.85	1.23	.98	.85
HARD BINDING - Adhesive Bound and Plastic Cover	11.55	4.90	2.78	1.71	1.07	.86	.73
PAPER BINDING - Smyth Sewn	11.54	4.76	2.65	1.59	.95	.72	.60
PAPER BINDING - Adhesive Bound	$11.48	$4.72	$2.60	$1.54	$ .90	$ .68	$ .56

* 25M copies or less printed on sheet fed offset press; over 25M copies printed on web offset press, which delivers folded signatures and thus lowers binding costs.

is intended to suggest the answer to an often heard question: "Why can't textbooks and other kinds of professional books be produced and sold in very cheap paperback editions?"

The mass-market paperback reprint is altogether a different economic package. Its plant cost is almost nil; the quality of its printing and materials is very low; its market has been well established by the original edition, so it can be printed in quantities ranging up into hundreds of thousands of copies. In short, the economy of scale in its production operates on a very different order of magnitude.

Marketing Costs. These costs, which are next highest to production costs, can be divided into two major categories: (1) personal selling costs, including the salaries and expense of field sales and sales management staff; and (2) advertising and promotion costs, including those of space and direct mail advertising, of catalogs, of publicity and exhibits, and of free promotional copies.

As noted earlier, field sales expense runs to high levels in educational publishing -- this because competition for markets is both wide and direct. For a large school book publisher with a numerous sales staff that gives away free sample copies by the thousands, this category of sales expense is usually as high as 16-20% of net sales. For a large college publisher, it can amount to 10-14%. These levels are about twice as high as those for trade and professional book publishers.

On the other hand, space advertising is not a large item of expense, except in trade book publishing, where it normally amounts to 5-6% of net sales annually. Most trade book houses budget advertising expense for each new book at 8-10% of the anticipated net sale for the first year. If sales run higher than anticipated, the budget is extended accordingly, if sales do not come up to expectation, the budgeted amount may not be spent.

Direct mail advertising is an important item of expense for only the publishers of professional books and of other high priced books produced for the special-interest reader. Here it amounts to a large portion of the total marketing cost, because the only way most individual buyers can be reached effectively is through special-interest mailing lists. It is a costly marketing mechanism. Given the high cost of selling and serving single-copy orders, a publisher cannot today afford to undertake direct mail selling of any book that is priced below $8.00 or $10.00

To date, only a few publishers of mass-market books have been able to make TV and radio advertising pay off. In most geographic broadcast areas, the market for books is too thin for successful exploitation by these media. Still a number of houses continue to experiment with both TV and radio promotion in hopes of finding a better key to mass-market selling.

Order Fulfillment Costs. The primary items in this accounts group are the costs of warehousing, billing, and shipping. Secondary items are the costs of customer service (communications with customers concerning their orders and returns) and of handling the returns of unsold books.

The prudent publisher must think of fulfillment costs in terms of the market served, for there are wide variations that are directly related to the scale of quantities shipped. At the low end of the scale is the per copy fulfillment cost of paperbacks that are shipped to jobbers in quantities of hundreds or thousands. At the high end is the professional book that is usually shipped on a single-copy order to the individual buyer. Thus, the publisher in calculating a P & L estimate for a new P & L book must apply the actual per copy fulfillment cost rather than a percentage cost of the net price. At the present time, this cost varies from about 3¢ per copy for mass-market paperbacks to as much as 60¢ per copy for professional books.

The publisher who specializes in mail order books has relatively a low per copy fulfillment cost. This is because a small number of titles are warehoused, and there

is a mechanized system for billing and shipping single copies from prepackaged. inventory. By contrast, the large general publisher or the jobber, who may warehouse as many as 10,000 to 100,000 titles, has an excessively high cost in filling the single-copy order on a random, on-demand basis. In fact, if the single-copy order is for a low-priced book, the typical publisher loses money on the sale.

The high cost of handling returns of unsold books is not, as a rule, broken out as a separate item in publishers' accounts. Instead, it is taken as a natural part of total shipping and receiving costs. Yet, it is a very onerous cost, and apparently publishers prefer not to face its reality in P & L statements. Almost all houses have ground rules that are supposed to limit returns, but these rules are more often ignored than enforced. The result is a high rate of out-and-in shipments of inventory that have reached almost unbelievable levels in several areas of publishing. The highest rate is in mass-market paperback publishing, where about 43% of the value of all books shipped out are later credited as returns. Rates in other areas that have steadily increased in recent years are 13% for college books, 14% for trade books, and 12% for professional books. The foregoing percentages are based on gross sales; translated to a net sales basis, they are paperbacks, 75% ; college, 18%; trade 16%; professional 14%.

Publishers have long deplored these high rates of returns -- one doyen of the industry is said to have remarked ruefully, "It seems that much of my inventory is gone today and here tomorrow." Still, no one has attempted to change the system or even to account for its cost. My private and very rough analysis indicates that the expense of the double handling of unsold books is currently between $45 million and $50 million annually. (This is the publisher's expense of out-and-in handling costs alone, not including carriage charges, which are paid by the customers.) Admittedly, it is impossible to formulate even a rough estimate of how many more books are sold by reason of the liberal return allowances. All that can be said for certain is that the present system is almost universally accepted as being a very costly, but necessary

evil. Indeed, many publishers and most booksellers believe that if liberal return priveliges were not allowed, the whole book distribution system would collapse overnight.

General and Administrative Expense. This group of accounts (often labeled Overhead Expense) includes: compensation and expense of general officers and managers; rent and other real estate expense; accounting and data processing; office services; personnel services and employee benefits; social security and property taxes. In the P & L statements of most publishers this category of expense does not include such corporate income-and-expense items as fees for outside legal and auditing services, interest paid on loans, income from invested capital, and the like.

Since book publishing is a nonmanufacturing industry and almost all its employees are salaried, the cost of employee compensation and benefits runs higher than it does in most other industries. Also, because almost all publishers are located in high-rent metropolitan areas (concentrated largely in New York, Boston, Philadelphia, and Chicago), the cost of occupancy runs unusually high. These factors, plus the high cost of accounting for myriads of sales and royalty transactions, combine to push up the industry's general and administrative rate to a total that is considerably higher than that of most other industries.

Pricing Policy and Practice. There are several factors that must be a part of any formula for establishing the list price of a new book: (1) the fixed plant cost; (2) the unit cost, which varies with the number of copies printed; (3) the discount at which the book will be sold (or the relationship between the list and the net price); (4) the royalty cost, which may vary with the levels of cumulated sales; (5) the estimated per copy cost of

order fulfillment, including the prospective cost of handling returns; (7) the time factor of inventory turnover, with which is related the cost of maintaining slow-selling inventory; (8) the unit cost of a reprint, which can vary widely with different kinds of books having different sales levels.

In addition to these tangible factors, two intangible ones often have to be considered: (1) the physical size and appearance of the book as a consumer package; and (2) the limitation of what the prospective consumer is able or willing to pay.

Book pricing was traditionally a personalized art -- something that was learned largely by trial-and-error experience. The publisher knew his production costs and operating expense rates; in some areas he knew his markets, in others he had to guess them. From this knowledge he could deduce certain rule-of-thumb formulas for profitable pricing of various kinds of books. He knew that the typical school textbook had to be priced roughly at three or four times its production cost; and that the multiple for a college text was four or five; for a trade book five or six; for a specialized treatise or mail order book, six, seven, or even eight. Using these rough formulas, he applied a kind of mental calculus and came up with prices that often were taken to be the product of "seat of the pants" intuition.

Today, book pricing usually is done in a far more scientific way. Most publishers now have, or have access to, computer facilities that produce for each new book a range of hypothetical models of profit-and-loss results. These models provide alternatives for a far more precise application of the publisher's judgment -- which will always be, of course, the most important ingredient of the pricing process.

Direct competition in the marketplace is an important factor in pric-

ing certain kinds of books, notably textbooks and standard reference works such as dictionaries, atlases, almanacs, handbooks, encyclopedias etc. The publisher of such books always keeps a sharp eye on the prices of directly competitive books, and this comparative attention operates to keep prices down. In other areas of publishing where potential purchasers customarily do not make a selection of one book against another, only general competition for the consumer's dollar is a factor in price determination.

A peculiar pricing practice that confuses the general public occurs when a new book is published in both hard-cover and papercover editions. Customarily, the former is overpriced and the latter is substantially underpriced -- and the publisher hopes to gain through additional sales what is lost on the profit margin of the paperback edition. Often the hard-cover edition is produced only to satisfy the demand of those libraries that will not buy paperback books.

In pondering the range in prices of different kinds of books, one should always keep in mind the fact that there is a wide difference in the publisher's net receipts after deductions from the list price for dealers' discounts and authors' royalty. The range of the receipts after such deductions is from approximately 70% of list price for professional books to approximately 43% for mass market paperbacks. The amount is, in effect, the publisher's "take-home pay" from the average sales transaction in his particular area of publishing. Naturally, list prices must reflect these variations as well as those in production costs and operating expenses.

Export Sales. For the book industry as a whole, export sales are of minor importance in both volume and profitability. Statistical records

in the area are incomplete and flawed, but experts estimate the volume to be about 5-6% of the total annual sales of the U.S. book industry. However, export sales are quite important in certain subject areas of publishing, notably in science, technology, medicine, business administration, and industrial management. Publishers who specialize in one or more of these areas can export as much as 20% to 30% of their product. Indeed, an authoritative treatise or monograph in any of them often sells as many copies abroad as at home.

Several adverse conditions make export selling unattractive to the average U.S. publisher. In most foreign countries, markets are thin, sales costs are high, and purchasing power is low. (Great Britain, Canada, Australia, and Japan are exceptions to this rule.) In addition, the terms and risks of customer credit are costly, which is to say that compared with domestic experience, collections take far longer and losses on defaults are far higher. Further, in many countries,there is always the difficult problem of arranging adequate allowance of soft-currency exchange for dollar payments. Faced with these adverse conditions, the U.S. publisher has to work very hard to make a satisfactory direct profit on export sales. This appears to be the reason why most firms are content with their exploitation of home markets.

The unfavorable conditions that depress direct profits on export sales are mitigated by an advantage that indirectly adds to profit. This is the additional profit that results from larger printings at lower unit costs of specialized books -- larger printings that are made possible by the addition of export sales to ordinarily limited domestic sales. To illustrate: If the publisher of a specialized treatise in science can print, say, 2,000 copies for export sale in addition to 3,000 copies for

domestic sale, he effects a sharp reduction in the per-copy production cost and thus substantially increases the margin for profit on domestic sales. The result is a hidden profit, but it is nonetheless real, and it serves as an incentive to keep the specialized publisher hustling for foreign sales. Indeed, many monographic works now produced in the United States could not be published for domestic markets alone. Only the total international market -- the combination of domestic and foreign sales -- is sufficient to sustain the costs of publishing the majority of such works in our country today.

Economic Impact of New Technology. Recent technological advances in printing and reprography have both helped and harmed the book industry. The help has come on the production side, the harm on the utilization side.

On the production side, the past two decades have seen a number of significant improvements in the machinery and processes for printing and binding. Computer-assisted composition has reduced the time and cost factors in producing many kinds of books, especially those that must be revised and republished periodically, such as directories, handbooks, dictionaries, encyclopedias, and volumes of statistical and numerical data. Further, the wide employment of vastly improved techniques of photocomposition (typesetting on film) has eliminated much of the hand-skill technology and cost of traditional hot-metal composition. And new equipment for automatic plate-making from film has had the same effect in this costly area of production.

Many advances have been made also in the technology of presswork and

binding. Gigantic offset web presses that deliver folded sheets now produce books at rates of speed and cost reduction that were undreamed of thirty or forty years ago. One of the most notable of all improvements has come in the cost and durability of adhesive binding, which has not been as widely accepted and used as it should be.

Unfortunately for the average publisher, much of the new printing technology can be applied only to straight-matter books that are printed in quantities of 10,000 copies or more. This means that about 60% of the new books published today do not qualify (or, rather, quantify) for the benefits. However, there has been some economic gain in the development of short-run offset web presses that deliver folded signatures and permit very fast plate changes and low spoilage of paper. The use of such presses eliminates much of the slow and costly "make-ready" operation that was necessary in changing plates on the old style letterpress machines. But these new presses can be used to large advantage only when several books having the same format and paper specifications can be "gang printed" in a single press run. Therefore, only the larger houses are able to take full advantage of the scheduling requirements of these new presses.

Another area where costs have been reduced by improved technology is the composition of books that have high content of numerical and symbolic characters. Here typesetting that was traditionally done by a combination of Monotype and hand composition is now done by monofilm, which is an application of Monotype equipment to photo composition with film rather than metal. This process has effected big savings in the composition of complex mathematical equations, chemical formulas, etc. Still, a good part of this process, although it is computer assisted, must be done by skilled hands.

In general,it can be said that, although much progress has been made

in several areas of composition and printing technology, there has been no truly revolutionary development in recent years. And certainly, the advances on the whole have not resulted in large reductions of production costs.

Some observers of the publishing scene have urged that more attention be given to the practicability of original publishing in micrographic form -- by microfilm, microfiche, or microprint. To date, this form has been successfully employed only for republication of out-of-print works -- for serials and large volumes of collected papers and for multivolume classics first published in book form. Here, the profitable ventures have been massive and high-priced packages that are sold by subscription in advance of publication. A few commercial firms and two or three university presses have experimented with microform publishing of current single-volume works, and the result in nearly every case has been economic failure. This failure can be attributed to several factors: (1) user resistance, which is caused largely by the fact that effective and moderately priced reader/printers have not yet been perfected; (2) marketing and fulfillment costs, which are unbearably high in relation to acceptable levels of sales price; and (3) slow "on demand" sales of prints made from a master negative or plate, which are neither immediate enough nor large enough in dollar volume to be attractive for entrepreneural investment. In short, the technology of the software is acceptable, but that of the hardware is not, while the economics of pricing and of selling and distribution to the individual customer is impossible. But in spite of current failures, some book publishers still believe that micrographics will one day be widely used for several kinds of limited edition works. Certainly, continued experimentation with the medium can be expected.

As to the harmful impact of the new reprographic technology, the core question is whether, and by how much, unauthorized and possibly unlawful photocopying of copyrighted works is reducing book sales. Almost everyone concerned agrees that such copying is extensively done, but there is wide disagreement on the extents of its legality and of its adverse effect on the book industry.

Book publishers, along with most of their authors, re convinced that unrestrained photocopying has for some years reduced the sale of several classes of books that lend themselves to copying in part, including anthologies, encyclopedias, dictionaries, handbooks, statistical reports, science monographs, etc. Copyright owners are especially concerned over library photocopying -- copying of a kind and in an amount that substitutes the copied part for the book itself and thereby decreases the demand for the original work. They are also concerned over recently increased photocopying that has been made expedient and feasible at borrowing libraries by revved-up systems for interlibrary loans. Here they see an added depression of sales that is the direct consequence of the recent growth of statewide and regional library networks that offer high-speed retrieval of bibliographic information plus remote catalogue access and circulation control. These computer-based services have greatly facilitated the borrow-and-copy process, and thus they have made satellite libraries far less dependent on their own holdings. The result is an extension of use of the original publication in a system where a single copy now suffices where four or five copies were needed a few years ago -- and where, it is feared, the future relationship could be one to 20 or 30. In short, authors and publishers together believe that they are now suffering increasing economic damage from photocopying by, at, or near the

insular library, and that they will inevitably suffer much more from systematically organized facilities for copying within library networks.

To the contrary, librarians and certain classes of users of library services (notably educators and researchers) claim that the extent of the damage has been exaggerated in a misleading way. They insist that they must have more freedom from copyright restriction, else their professional efforts in behalf of progress and the public welfare will be seriously impeded. Further, most librarians claim that books are copied far less frequently and extensively than periodicals -- which seems to be true of research and special libraries, but not true of educational and public libraries. In short, they either dismiss or heavily discount the publisher's claim of economic damage.

Unfortunately, there is little solid evidence to support either side of this argument. It is also unfortunate that the issue is deeply enmeshed with the effort to revise our antiquated copyright law -- an effort that has gone on in a desultory way for some fifteen years. The situation cries out for a thorough, factual, and objective study that will be conducive to more light and less heat in the current controversy.

NOTES AND REFERENCES

1. Almost the same result would be obtained by applying reliable industry estimates of book-price increases in recent years, namely 3-4% annually.
2. These annual statistical reports are not reliable for historical comparisons. The ground rules for their compilation have changed from time to time; for example, reprint and paperback editions were counted as new productions for the first time in 1970, which caused an aberrational increase of 22% for the one year alone. Further, the system

at Publishers Weekly for gathering industry-wide information has been improved in recent years. Hence, the rate of actual increase in new book production has not been as high as the Publishers Weekly record indicates.

3. E. E. Booher. "What Has Happened to the Intellectual Entrepreneurs"? New York, 1974. Columbia University Distinguished Leaders Lecture Series.